ST 00-0262-GIL 11/27/2000 COMPUTER SOFTWARE

If transactions for the licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software or the subsequent software updates will be subject to Retailers' Occupation Tax. (This is a GIL.)

November 27, 2000

Dear Xxxxx:

This letter is in response to your letter dated September 27, 2000. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120(b) and (c), which can be found on the Department's website at http://www.revenue.state.il.us/legalinformation/regs/part1200.

In your letter, you have stated and made inquiry as follows:

The purpose of this letter is to request a ruling as to whether or not the attached license agreement qualifies as a license of software under Illinois Regulation Section 130.1935.

Facts

Our client is a software company that is located in Illinois. The client generates revenue by licensing its software to users in the medical profession. Most of the users of the software are non-profit hospitals with a valid Illinois exemption number. However, the client occasionally will license the software to taxable entities.

Analysis of Law

Based on our review of the enclosed license agreement, it appears that it meets the requirements of Illinois Regulation Section 130.1935. The following provides an analysis of the five requirements listed in Illinois Regulation Section 130.1935 as they pertain to the attached license agreement.

Requirement Number 1 – It is evidenced by a written agreement signed by the licensor and customer. The attached license clearly meets this requirement since page seven of the agreement clearly indicates that the customer and the licensor must sign the agreement.

Requirement Number 2 – It restricts the customer's duplication and use of the software. The attached license appears to meet this requirement since on page one, under Grant of License, the agreement restricts the customer's use of the software and clearly provides that the customer cannot copy the licensed software.

Requirement Number 3 – It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party). The attached

license agreement meets this requirement since on page one, under Grant of License, the agreement provides that the customer cannot sublicense or sell the software.

Requirement Number 4 – The vendor will provide another copy at minimal or no charge if the customer loses or damages the software. This requirement is not specifically indicated in the license agreement. However, it is our understanding that our client would provide another copy of the software if the software was damaged or lost by the customer.

Requirement Number 5 – The customer must destroy or return all copies of the software to the vendor at the end of the license period. The agreement does not provide that the software must be returned at the end of the license agreement since it is a perpetual license. Based on Illinois letter rulings reviewed, it is our understanding that the Illinois Department of Revenue has deemed perpetual licenses to qualify for this criteria even though no provision is included in the agreement that requires the return or the destruction of the software (Illinois GIL 98-0322). As such, it appears that the license agreement would meet this requirement.

Based on our interpretation of Illinois Regulation Section 130.1935, it appears that the license agreement meets the five criteria and would qualify as a nontaxable license of software. However, our client respectfully requests that your office reviews the enclosed license and advises us as to the whether or not the enclosed license meets the requirements of Illinois Regulation Section 130.1935.

We sincerely appreciate your help in this matter. If you have any question or need additional information, please call me at ####.

86 Ill. Adm. Code 130.1935, Computer Software, has been recently amended. See enclosed revised copy of Section 130.1935. Generally, sales of "canned" computer software are taxable retail sales in Illinois. However, if the computer software consists of custom computer programs, then the sales of such software may not be taxable retail sales. See Section 130.1935(c).

Custom computer programs or software are prepared to the special order of the customer. The selection of pre-written or canned programs assembled by vendors into software packages does not constitute custom software unless real and substantial changes are made to the programs or creation of program interfacing logic. See Section 130.1935(c)(3).

If transactions for the licensing of computer software meet all of the criteria provided in Section 130.1935(a)(1), neither the transfer of the software or the subsequent software updates will be subject to Retailers' Occupation Tax. A license of software is not a taxable retail sale if:

A) It is evidenced by a written agreement signed by the licensor and the customer;

B) It restricts the customer's duplication and use of the software;

C) It prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party) without the permission and continued control of the licensor;

D) The licensor has a policy of providing another copy at minimal or no charge if the customer loses or damages the software, or permitting the licensee to make and

keep an archival copy, and such policy is either stated in the license agreement, supported by the licensor's books and records, or supported by a notarized statement made under penalties of perjury by the licensor; and

E) The customer must destroy or return all copies of the software to the licensor at the end of the license period. This provision is deemed to be met, in the case of a perpetual license, without being set forth in the license agreement.

In the context of a General Information Letter, the Department cannot give you a binding ruling as to whether the agreement you attached to your letter meets the requirements of Section 130.1935. Our review of your client's license agreement shows that it has explicit written provisions that satisfy requirements A, B, and C. Further requirement E is met because the agreement is a perpetual license. However, the agreement does not contain a provision that satisfies requirement 4, that the vendor (licensor) will provide another copy at minimal or no charge if the customer loses or damages the software.

While the agreement does not contain an explicit provision that satisfies requirement 4, you state in your letter that it is your understanding that your client would provide another copy of the software if the software was damaged or lost by the customer. However, based upon our review of the entire Software License Agreement we cannot conclude requirement 4 is satisfied and we find software transferred under this agreement to be taxable. Section 15 of the agreement provides that the customer's sole and exclusive remedy shall be the removal and de-installation of the system. Also in that section, the company disclaims all other warranties including hardware malfunction, operator error or any other problems which may develop outside of the companies control. The case of a software defect is the only instance where the software will be fixed or where money will be partially refunded. Most importantly, Section 23.11 states as follows:

"Entire Agreement; Amendment. This Agreement (including all schedules and exhibits attached hereto, which are incorporated herein by reference) shall constitute the complete and entire agreement of the parties with respect to the subject matter hereof and supersedes all prior proposals, agreements and representations between them, whether written or oral. The parties have read this Agreement, and they agree to be bound by its terms. No provision of this Agreement may be waived or modified unless such waiver or modification is in writing and signed by authorized representatives * * *. ANY ORAL OR WRITTEN REPRESENTATION OR WARRANTY NOT EXPRESSLY CONTAINED HEREIN SHALL NOT BE ENFORCEABLE."

Because Section 23.11 specifically restricts the parties' agreement to the subject matter therein, we must conclude that requirement 4 is not satisfied. Accordingly, transfers of software under this agreement would subject your client to Retailers' Occupation Tax liability.

I hope this information is helpful. The Department of Revenue maintains a website, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of the enclosed copy of Section 1200.110(b).

Very truly yours,

Melanie A. Jarvis
Associate Counsel

MAJ:msk
Enc.